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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS

Docket No. T-00000D-00-0672

COX ARIZONA TELCOM, L.L.C.'S
COMMENTS TO DECEMBER 3, 2001
PROCEDURAL ORDER

Cox Arizona Telcom, L.L.C. ("Cox") submits the following comments on the questions posed in the December 3, 2001 Procedural Order in this docket.

1. Do you believe that the Commission ought to restructure access charges? Please explain your response.

Response: It is appropriate that the Commission continue to evaluate the effectiveness of access rate levels and structures in achieving its public policy objectives and restructure. However, maintaining rate stability for all parties participating in the access market should remain as a one of the Commission's policy considerations. The Commission also should consider maintaining existing access charges or deferring any decision until the FCC conducts a significant restructuring of access charges.

2. What recommendation to the Commission would you make regarding how intrastate access charges should be reformed?

Response: There are a variety of creative approaches to access charge reform, but none are without drawbacks. The theoretical benefits of these approaches must be weighed against the potential for shifting the access burden too much to consumers in fixed costs or destabilizing telecommunications revenue flows, particularly for new and

1 recent market entrants.

- 2 3. **Would you recommend the Commission address both switched**
3 **and special access in an access charge reform proceeding? If**
4 **your response is yes, please explain.**

5 Response: It is not necessary that the Commission address both switched and
6 special access. Although the services are somewhat cross-elastic, it is unlikely that an
7 intrastate special access restructure could significantly influence the overall rate rela-
8 tionship between intrastate switched and special access. First, special access is most often
9 jurisdictionally interstate due to the de-minimus rule of jurisdictional classification of
10 dedicated services. Second, pricing for special access services approximates a true
11 competitive outcome to a much greater degree than switched access pricing. Consequently,
12 the Commission's ability to revise special access rates in concert with a switched access
13 restructure without distorting special access rates and competition appears limited.

- 14 4. **Parties who desire that switched access charges be reformed**
15 **often state that switched access charges in general, and the**
16 **CCL rate element in particular, contain implicit subsidies. Do**
17 **you agree with this statement? Please provide an explanation**
18 **of the rationale for your position, including any computations**
19 **that you might have made.**

20 Response: Switched access charges, and the CCL charge in particular, do contain
21 subsidies. This is true not because switched access is priced too high overall, or because
22 access is billed to carriers rather than end users, but because of the structural dissimilarity
23 between how costs are incurred and how these costs are recovered. In effect, these are not
24 true subsidies but rather are mismatched costs. The CCL charge, for example, contains
25 subsidies because it recovers, by definition, nontraffic-sensitive costs with traffic-sensitive
26 rates. Other usage sensitive switched access rate elements also contain substantial
27 nontraffic-sensitive costs. Such a structure creates a subsidy that ultimately flows from
high volume toll users to low volume toll users. This mechanism has historically kept
monthly recurring line rates low. Historically switched access rates have been set above

1 long run incremental costs, and as a result, they have contributed to the recovery of joint
2 and common costs.

3 **5. Can implicit subsidies be quantified?**

4 Response: Yes, they can be, by determining the long run incremental costs of
5 each service that shares any joint and common costs. However, the rooting out of implicit
6 subsidies should not be the only objective. The Commission has other policy objectives
7 (such as providing affordable basic service at averaged rates or nondiscriminatory service).
8 For example, basic exchange service is priced at a single rate even though the cost of
9 service through shorter loops subsidizes service through longer loops.

10 **a. What is the appropriate cost standard to be used to**
11 **determine whether access charges are free of implicit**
12 **subsidies?**

13 Response: Some variation of long run incremental costs (TELRIC) could be used to
14 determine whether any single service is receiving a subsidy. But the Commission cannot stop
15 there, because it must then address how it will recover the joint and common costs. It is not
16 unreasonable that every service that uses the local loop provides some contribution to the recovery
17 of the costs of the loop – however the structure of such cost recovery should more closely match
18 the nature of the cost. Where a large part of the cost of a set of services is a joint cost (one that
19 cannot be avoided if any one of the services is offered), it is difficult to make an allocation of that
20 joint cost that is absolutely right. In such a case, a price exceeding the range between the stand-
21 alone cost for any one product, and its long run incremental cost (with some contribution toward
22 the joint cost) would be an appropriate measure of whether a subsidy exists. It is important to
23 understand the degree of structural dissimilarity between how costs are incurred and how these
24 costs are recovered. Such a study should not be limited to the access market, however, since
25 switched access services and local services are inextricably linked, and since the joint cost of the
26 loop (which is used for both) must be recovered somehow. If incremental costs alone were the
27 determinant, the Commission would find that a variety of additional "subsidies" exist – business

1 customers subsidize residential customers, feature users subsidize non-feature users, low-usage
2 local customers subsidize high usage local customer, etc.

3 b. **What cost standard is used to set interstate access**
4 **charges? Is this cost standard appropriate for intra-**
5 **state rates?**

6 Response: Interstate rates are the product of historic fully allocated costing, as well as
7 some incremental costing. Price Cap ILECs no longer cost-justify their rates, but rather change
8 rates based on the Price Cap Model.

9 6. **Do you believe that interexchange carrier switched access**
10 **charges ought to exist? Please provide your rationale for your**
11 **position on this matter.**

12 Response: A theoretical case can be made that interexchange carrier switched
13 access charges – at least as presently structured – should not exist, and that access costs
14 should be borne directly by end users. However, since IXC access charges have existed in
15 some form or another for decades, and since all market participants – end users, IXCs and
16 LECs – have had their behavior and expectations influenced by them, their elimination
17 carries high potential for destructive market disruption. In the absence of an interstate shift
18 to eliminate IXC switched access charges, such a plan would be highly impractical and
19 disruptive to implement on a state by state basis.

20 While there are arguments regarding the pure efficiency of the traditional access
21 charge structure, certain public policy objectives have been achieved. Interexchange carrier
22 switched access charges have funded ILEC network expansion and improvements while
23 helping to keep local exchange rates low.

24 7. **Please provide the following to assist in developing a rough**
25 **estimate of the extent to which implicit subsidies exist in access**
26 **charges assessed by Arizona local exchange companies.**

- 27 a. **What is your estimate of the implicit subsidies in access**
 charges that exist on a statewide basis?

 b. **Please explain how that estimate was developed.**

c. **What is your estimate of the existing implicit subsidies that exist by local exchange company?**

Response: Cox has not performed an analysis of Arizona state access charges, and as such cannot comment on the specific level of subsidies that may exist in current ILEC rates. However, as noted above, if incremental cost is the comparison point, incumbent telecom pricing is replete with subsidies. Quantifying subsidies in access services alone, however, can easily yield results that are not meaningful. Since only a small fraction of network costs are wholly attributable to access services, switched access is often viewed as almost all subsidy. Similarly, however, only a small fraction of these same network costs are wholly attributable to local exchange services. The vast majority of telecom network costs are shared by both local exchange and switched access services. Neither access services nor local exchange services can be clearly defined as subsidizing the other. Both service categories contribute revenues which exceed the incremental costs specific to each service category, and both make contributions toward common costs.

Subsidies, then, are found not in switched access as a service category, but in all prices that reflect structural dissimilarities with the underlying incremental costs.

8. **Should access charges be set at the same rates as unbundled network elements for the same network elements and functionalities? Please explain your response.**

Response: Not immediately. In isolation it would be reasonable to assume that like functions should all be priced the same – and in the long run they probably will be. However, potentially dramatic shifts of prices in one category of telecommunications service would certainly impact rates in other categories. Since switched access, particularly on a terminating basis, is relatively insensitive to competition, rate reductions in switched access services would likely have to be shifted to other services similarly insensitive to competition. This would likely place most of the burden on residential ratepayers; not business or toll users. Again, the potential for market disruption is high if this transition is too quick or unpredictable.

1 9. Your responses to the following questions will assist the
2 Commission in determining how to proceed with this case from
3 a procedural perspective.

4 a. What procedure would you recommend be used to
5 address switched access charge reform? For example,
6 would you recommend a generic proceeding to address
7 the issues in general with the objective being the reform,
8 restructure and resetting of switched access charges for
9 every LEC in the State?

10 Response: Initially, the Commission should conduct a generic proceeding to
11 address overarching policies related to access charge reform. Any such generic
12 proceeding should include all LECs in the state. After the generic proceeding, the
13 Commission may conduct appropriate follow-up proceedings as necessary.

14 b. What issues do you believe should be addressed in a
15 proceeding to determine whether and to what extent
16 intrastate access charges ought to be reformed?

17 Response: The Commission should identify the shortcomings, if any, of the
18 existing access charge structure to achieve its public policy objectives. Any restructuring
19 must identify how the existing problems will be reduced or eliminated, and how other
20 policy objectives, such as reasonable local service rates and the development of meaningful
21 local competition and increased consumer choice will not be compromised. Additionally,
22 there may be benefits to keeping access charges structurally consistent with interstate
23 access until such time as the FCC undertakes significant access reform.

24 c. Would you recommend that the Commission limit the
25 initial switched access charge proceeding to the largest
26 ILECs in Arizona? If your response is yes, please
27 identify those companies that you believe should be
28 included in this proceeding.

29 Response: Refer to (a) above.

30 d. Would you recommend that the Commission address
31 access charge reform for large, intermediate and small
32 local exchange companies (as defined in the Commis-
33 sion's Arizona Universal Service Fund rules)
34 individually? Please explain.

1 Response: Refer to (a) above.

- 2 e. **Would you recommend that the proceeding address**
3 **switched access charges assessed by CLECs and/or**
4 **other telecommunications companies?**

5 Response: Refer to (a) above. Additionally, while it is appropriate to address all
6 LECs in one initial generic proceeding, the policy implications unique to each category of
7 LEC may warrant separate follow up proceedings.

- 8 f. **Given your vision of what the proceeding would**
9 **address, how much time do you expect would be**
10 **required to complete the proceeding?**

11 Response: The Commission should take as much time as necessary to conduct a
12 thorough investigation and analysis of the issue.

- 13 10. **For companies that provide access service, please provide the**
14 **dollar amount of revenues from switched access charges that**
15 **you received by rate element, by month, for the period July 1,**
16 **2000 through June 30, 2001.**

17 Response: This information is confidential and Cox will provide the information
18 to Commission Staff pursuant to an appropriate protective agreement.

- 19 11. **For companies that purchase access service, please provide the**
20 **dollar amount of the payments for switched access charges that**
21 **you made (by company, rate element, and month if possible)**
22 **for the period July 1, 2000 through June 30, 2001.**

23 Response: This information is confidential and Cox will provide the information
24 to Commission Staff pursuant to an appropriate protective agreement.

- 25 12. **Do you believe that it would be possible to eliminate the**
26 **potential that local exchange service providers can exert**
27 **monopoly power in the access service market by assessing the**
 switching, transport and CCL charges on the end users rather
 than on interexchange carriers? Could customers then shop
 for local exchange service customers for the least cost provider
 of access in addition to local service, etc.?

Response: Yes. Assessing access charges as presently structured to end users
 would make access charges directly susceptible to competitive pressures. However,

customer confusion under such a structure – particularly if other jurisdictions did not follow suit – would appear to outweigh any theoretical benefits. Such a move would have no immediate impact on the issue of subsidies and pricing efficiency.

Customers simply would not tolerate such a complex disaggregation of their long distance charges. Consequently, any move to shift access cost recovery directly to end users must be accompanied by a complete restructure of access charges away from usage sensitivity.

13. **Do you believe that there is a difference in the costs of providing interstate switched access service versus intrastate-switched access service? In your response, please include a description of how costs are defined in your response and how those costs relate to costs allocated to the intrastate jurisdiction under the FCC's Separations rules.**

Response: The only difference between interstate and intrastate access costs are those determined by cost allocation methods and or subsidies. These allocations and subsidies are essentially arbitrary.

14. **In the CALLS Decision, the FCC implemented changes that would eliminate carrier common line charges and establish an interstate universal service support mechanism. Do you believe that the Commission ought to address the Arizona Universal Service Fund mechanism concurrent with the reform of intrastate access charges?**

Response: Inasmuch as USF and switched access charges are used to effect some of the same public policy objectives, it is appropriate that they be evaluated concurrently.

15. **The FCC released its Access Charge Reform Order ("MAG Order") for rate of return companies on November 8, 2001. Please comment on the extent to which you believe the ACC should adopt any components of the MAG Order.**

Response: Cox takes no position on this issue at this time.

16. **Should the Commission address CLEC access charges as part of this Docket?**

Response: Yes. Both CLEC and ILEC access charges should be evaluated in light of the relevant public policy objectives. It should be recognized, however, that CLEC

1 access charges and ILEC access charges should not be artificially driven to parity. The
2 same set of policy objectives can lead to different outcomes for these very different market
3 segments.

4 Facilities-based CLECs have expended a substantial amount of capital in a relatively
5 short amount of time to provide a state-of-the-art telephone network; however, CLECs still possess
6 extremely limited market power. ILECs, on the other hand, have spent even greater amounts of
7 capital, but over a much longer period of time. And one of the larger factors for the ACC to
8 consider is that the costs associated with an ILEC's network are spread over a much larger
9 customer base and a far greater volume of switched access traffic, thereby reducing the per-minute
10 costs experienced by the carrier.

11 Further complicating matters is that these investments are comprised almost entirely of
12 joint, or common, cost components. That is, these network costs cannot be properly characterized
13 as either "local" or "access." Attempting to attribute costs to either local or access service
14 categories in isolation becomes an arbitrary exercise without meaningful results.

15 The ACC is charged with developing and promoting competition in the telecommuni-
16 cations industry, and as such, has the authority and the direction to implement industry guidelines
17 and regulations to protect and foster the emergence of CLECs who will bring competition to the
18 local markets. To this end, Cox urges the ACC to take a reasoned approach to access reform.
19 Such action will foster a stable environment that can be expected to lead to enhanced competition,
20 to the benefit of consumers.

21 The ILEC's scale and breadth of network leads to the most efficient cost basis for
22 providing access. While it may be appropriate to set a maximum rate above ILEC rates
23 that new entrants may charge for switched access, it would not be appropriate to force new
24 entrants to mirror the rate structure of much larger telephone corporations.

25 **17. Should additional considerations be taken into account when**
26 **restructuring and/or setting access charges for small rural**
27 **carriers? Please explain your response.**

1 Response: Yes. As with CLECs, rural ILECs can have rates that differ from
2 large ILEC rates, even when the public policy objectives used to determine the rates are
3 the same.

4 18. **What is the effect of Qwest's Price Cap Plan on the issues**
5 **raised in this proceeding as they pertain to Qwest? With**
6 **regard to Qwest, switched access is Basket 2 service and special**
7 **access is a Basket 3 service. What impact does this have, if**
 any, on restructuring access charges in this proceeding as it
 would pertain to Qwest?

8 Response: Cox has no comment on the impact of this proceeding on Qwest's
9 Price Cap Plan at this time. Restructuring switched access charges need not impact special
10 access pricing in this docket. As discussed earlier, the special access market is already
11 more competitive. Although a reduction in Qwest's switched access rates will make
12 Qwest's special access a less attractive alternative for some customers, there are other
13 factors (e.g., competitors) that can also affect Qwest's sales of special access (which is
14 why it is in Basket 3).

15 19. **With regard to Qwest, what impact would Qwest receiving**
16 **Section 271 authority have on the issues raised in this**
17 **proceeding? Please explain your response.**

18 Response: As Qwest enters the long distance market, and assuming that
19 interLATA toll falls into Basket 3, and is subject to a price floor above the component
20 parts of the service, then Qwest may become more sensitive to the changes in switched
21 access rates.

22 20. **One of the stated objectives of the Qwest Price Cap Plan was to**
23 **achieve parity between interstate and intrastate access charges.**
24 **Is this something that should be looked at by the Commission**
 in this proceeding?

25 Response: Substantial interstate/intrastate access rate disparity is one of many
26 issues the Commission should consider in this proceeding. However, complete access rate
27 parity would drive out any other policy matters the Commission may want to consider.

1 Complete parity abandons access charges as a policy tool for the Arizona Commission.
2 Moreover, as part of the recently-concluded Qwest rate case, the Commission will be
3 addressing appropriate price floors for the Price Cap Plan, including appropriate
4 imputation.

5 **21. Are there other issues besides the rate restructuring and**
6 **costing issues raised herein that should be addressed by the**
7 **Commission in this Docket?**

8 Response: Cox does not believe other issues need to be addressed in this docket
9 at this time.

10 **22. Are there other State proceedings and/or decision that you**
11 **would recommend the Commission examine before it proceeds**
12 **with this Docket? Please attach any relevant State commission**
13 **decisions to your comments?**

14 Response: The Commission may want to address price floors and proper
15 imputation under R14-2-1310 before setting any new access charges. *See* ACC Decision
16 approving Qwest Price Cap Plan.

17 **23. Please provide your recommendations for a procedural**
18 **schedule in this case.**

19 Response: Cox would defer to the Commission on the procedural schedule.

20 **24. Please comment on the issues raised in Docket No. T-01051B-**
21 **01-0391, In the Matter of Qwest Corporation's Tariff Filing to**
22 **Introduce a New Rate Structure for an Access Service Used by**
23 **Interexchange Carriers and their relationship to this Docket.**

24 Response: Qwest has withdrawn that tariff filing. Qwest should not be allowed
25 to restructure its access charges – particularly along the lines proposed in that docket –
26 until this docket is concluded.

27 **25. Please comment on any other issues you believe may be**
relevant to the Commission's examination of intrastate access
charges.

Response: None at this time.

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